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1 FINANCE AND ADMINISTRATION CABINET

2 Department of Revenue

3 (Amendment)

4 103 KAR 30:270. Oil and gas extraction machinery.

5 RELATES TO: KRS 139.010, 139.200, 139.260, 139.270, 139.280, 139.290, 139.310,  
6 139.330, 139.470, 139.480

7 STATUTORY AUTHORITY: KRS 131.130(1)

8 NECESSITY, FUNCTION, AND CONFORMITY: KRS 131.130(1) authorizes the  
9 Department of Revenue to promulgate administrative regulations necessary for the administration  
10 and enforcement of ~~[all tax laws in]~~ Kentucky tax laws. This administrative regulation establishes  
11 the sales and use tax requirements for transactions relating to the oil and gas extraction industry.

12 Section 1. (1) Definitions.~~[Definition:]~~ "Contract driller" means a person performing a drilling  
13 service for the owner or operator of an oil or gas well under a contractual relationship for  
14 consideration.

15 (2) "Repair, replacement, or spare parts" is defined in KRS 139.010(34).

16 Section 2. Eligible Property for Exemption. The storage, use, or other consumption of tangible  
17 personal property for use in the extraction or production process for oil or natural gas which will  
18 be for sale shall be exempt from the sales and use tax according to the provisions of KRS 139.010,  
19 139.470(9), [139.470(10),] and 103 KAR 30:120.

20 (1) The extraction or production process for oil shall be considered as beginning with the

erection of the drilling rig at the drilling location and shall be considered as terminating at the settling tank immediately prior to transportation. Oil tanks used for storage alone shall be subject to tax.

(2) The extraction or production process for natural gas shall be considered as beginning with the erection of the drilling rig at the location of the well and shall be considered as continuing until the gas leaves the outlet on the discharge side of the final gathering compressor station. The pipeline from the outlet to the transmission line shall be subject to tax.

(3) The list in this subsection shall serve as examples of machinery used in the extraction or production process:

- (a) Drilling rigs;
- (b) Casings;
- (c) Tubing;
- (d) Well head equipment;
- (e) Pumps;
- (f) Compressors;
- (g) Production and gathering pipe;
- (h) Cleaning equipment; and
- (i) Oil settling tanks.

(4) The list in this subsection shall serve as examples of other tangible personal property used in the extraction or production process:

- (a) Drilling bits;
- (b) Explosives;
- (c) Drilling muds; [and]

1 (d) Chemicals; and

2 (e) Fracking fluids, including water and sand.

3 (5) Tangible personal property shall not be exempt from sales and use tax if it is used as "repair,  
4 replacement, or spare parts" [~~as defined in KRS 139.010(26)~~].

5 Section 3. The extraction [~~Extraction~~] or production process shall include the following  
6 operations:

7 (1) Drilling and equipping wells, to include:

8 (a) Drilling of the hole by the drilling rig to the producing formation;

9 (b) Installing casing and tubing in the hole;

10 (c) Stimulating production by explosives or other means; [~~and~~]

11 (d) Hydraulic fracturing or fracking; and

12 (e) Completion of the well by the installation of machinery and equipment; and

13 (2) Pumping, gathering, and cleaning.

14 (a) Pumping shall include the use of separate pumps on individual wells, group well pumps,  
15 and auxiliary pumps at other points on the gathering system. The machinery and appurtenant  
16 equipment used in secondary methods of recovery including gas repressuring or waterflooding  
17 shall be considered part of the extraction or production process.

18 (b) The gathering system shall consist of a series of pipelines connecting several different  
19 wells with settling tanks grouped together for production purposes. Compressors used to stimulate  
20 production and to continue in effect the processing production operation shall be considered part  
21 of the gathering system.

22 (c) Cleaning operations shall occur in the final settling tank where impurities are removed  
23 from oil by chemical heating and settling processes. If a well produces both oil and gas, separator

1 equipment shall be necessary at appropriate points in the gathering lines to separate the oil and  
2 gas. In addition, various types of machinery may be used at different points in the gathering system  
3 to clean oil or gas.

4 Section 4. Nonproduction Process. Preliminary work, transportation, and marketing shall not  
5 be considered part of the oil or gas extraction or production process.

6 (1) Preliminary work shall include:

7 (a) Geological and geophysical work;

8 (b) Leasing or purchasing operations;

9 (c) Determination of drilling sites; and

10 (d) Surface work preparatory to drilling.

11 (2) The transportation of oil shall be considered as commencing when the oil is pumped from  
12 the settling tank into transportation facilities, which may be truck, rail, or pipeline, or a  
13 combination thereof.

14 (3) The transportation of natural gas shall be considered as commencing at the point where  
15 the production or gathering system ceases, and it is delivered into pipelines for transportation to  
16 the retail distribution system.

17 (4) The marketing of natural gas shall be considered as commencing when the pressure in the  
18 transportation line is reduced and the gas is delivered into a low-pressure system for distribution  
19 to the ultimate retail consumer.

20 Section 5. Contract Drillers. (1) The exemptions provided in KRS 139.470(9) ~~[139.470(10)]~~  
21 and 139.480(10) shall not apply to purchases made by a contract driller since[as] a contract driller  
22 is providing a service and is the consumer of the machinery and materials used to provide the  
23 service.

1       (2) A contract driller may jointly execute a "Certificate of Exemption Machinery for New and  
2 Expanded Industry," Form 51A111, with an oil or gas well owner or operator to purchase  
3 machinery used to provide drilling services to the oil or gas well owner or operator only if the oil  
4 or gas well owner or operator is the actual title owner of the machinery used to provide the drilling  
5 services after the contract between the contract driller and the oil or gas well owner or operator  
6 has been completed. ~~[A contractor may execute a "Certificate of Exemption Machinery for New~~  
7 ~~and Expanded Industry", Form 51A111, which is incorporated by reference in 103 KAR 3:020,~~  
8 ~~jointly with an oil or gas well owner or operator to purchase machinery only if the real or ultimate~~  
9 ~~ownership of the machinery lies with the owner or operator.]~~

10       Section 6. (1) This administrative regulation shall replace Revenue Circular 51C013.

11       (2) Revenue Circular 51C013 is hereby rescinded and shall be null, void and unenforceable.


12       Section 7. Forms. The form listed herein may be inspected, copied, or obtained applicable to  
13 copyright law, at: (1) The Kentucky Department of Revenue, 501 High Street, Frankfort, KY  
14 40601;

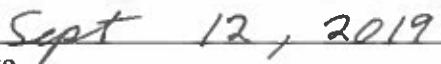
15       (2) A Kentucky Taxpayer Service Center, Monday through Friday, 8:00 a.m. to 4:30 p.m.; or

16       (3) The department website at <http://revenue.ky.gov>.

103 KAR 30:270

APPROVED BY AGENCY:

  
\_\_\_\_\_  
DANIEL P. BORK, COMMISSIONER  
Department of Revenue  
Finance and Administration Cabinet

  
\_\_\_\_\_  
Date

## PUBLIC HEARING AND PUBLIC COMMENT PERIOD

A public hearing on this administrative regulation shall be held on November 21, 2019, at 10:00 a.m. in Room 9B, State Office Building, 501 High Street, Frankfort, KY 40601. Individuals interested in being heard at this hearing shall notify this agency in writing by five (5) workdays prior to the hearing, of their intent to attend. If no notification of intent to attend the hearing is received by that date, the hearing may be cancelled. This hearing is open to the public. Any person who wishes to be heard will be given an opportunity to comment on the proposed administrative regulation. A transcript of the public hearing will not be made unless a written request for a transcript is made. If you do not wish to be heard at the public hearing, you may submit written comments on the proposed administrative regulation to the contact person.

**CONTACT PERSON:** Lisa Swiger, Tax Policy Research Consultant II, Department of Revenue, 501 High Street, Station 1, Frankfort, Kentucky, 40601, (502) 564-9526 (telephone), (502) 564-3875(fax), [Lisa.Swiger@ky.gov](mailto:Lisa.Swiger@ky.gov) (email).

## REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

Regulation No. 103 KAR 30:270

Contact Person: Lisa Swiger  
Phone Number: (502) 564-9526  
Email: Lisa.Swiger@ky.gov

(1) Provide a brief summary of:

(a) What this administrative regulation does: This administrative regulation establishes the sales and use tax requirements for transactions relating to the oil and gas extraction industry.

(b) The necessity of this administrative regulation: This administrative regulation is necessary to provide up to date guidance on the tax treatment of transactions made by and involving members of the oil and gas extraction industry.

(c) How this administrative regulation conforms to the content of the authorizing statutes: The proposed amendment updates regulatory language to conform with KRS 131.130 and KRS 131.131.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes: The changes made in this amendment will provide the most current and up to date guidance to taxpayers impacted by the provisions of this administrative regulation.

(2) If this is an amendment to an existing administrative regulation, provide a brief summary of:

(a) How the amendment will change this existing administrative regulation: The amendment will change this existing administrative regulation by adding a definitions section, adding tax treatment for property sold to aid in newer types of oil and gas extraction methods, adding a reference to the statutory definition of "repair, replacement, or spare parts" found in KRS 139.010(34), and updating statutory references.

(b) The necessity of the amendment to this administrative regulation: The amendment is necessary to provide up to date guidance on the tax treatment of transactions made by and involving members of the oil and gas extraction industry.

(c) How the amendment conforms to the content of the authorizing statutes: The proposed amendment updates regulatory language to conform with KRS 131.130 and KRS 131.131.

(d) How the amendment will assist in the effective administration of the statutes: The changes made in this amendment will provide the most current and up to date guidance to taxpayers impacted by the provisions of this regulation.

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation: All individuals, businesses, and organizations involved in the oil and gas extraction industry as well as their vendors that access the amended regulation.

(4) Provide an analysis of how the entities identified in question (3) will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

(a) List the actions that each of the regulated entities identified in question (3) will have to take to comply with this administrative regulation or amendment: No actions are necessary to comply with the amendment.

(b) In complying with this administrative regulation or amendment, how much will it cost each of the entities identified in question (3): There is no cost to comply with the amended regulation.



(c) As a result of compliance, what benefits will accrue to the entities identified in question (3): Anyone who accesses the amended regulation will benefit from the updated information contained therein.

(5) Provide an estimate of how much it will cost the administrative body to implement this administrative regulation:

(a) Initially: There is no expected cost to implement the proposed amendment. Current staff and budgeted funding will absorb the implementation of this administrative regulation.

(b) On a continuing basis: There is no cost expected on a continual basis.

(6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation: Current departmental staff and funding will be used to implement and enforce this proposed amendment.

(7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new, or by the change if it is an amendment: No additional funding or increase in fees is needed.

(8) State whether or not this administrative regulation established any fees or directly or indirectly increased any fees: No fees are directly or indirectly established or increased by the proposed amendment.

(9) TIERING: Is tiering applied? (Explain why or why not): Tiering is not applicable as the proposed amended regulation will be applied equally to all entities impacted by it.

## FISCAL NOTE ON STATE OR LOCAL GOVERNMENT

Regulation No. 103 KAR 30:270

Contact Person: Lisa Swiger  
Phone Number: (502) 564-9526  
Email: Lisa.Swiger@ky.gov

1. What units, parts or divisions of state or local government (including cities, counties, fire departments, or school districts) will be impacted by this administrative regulation? The Finance and Administration Cabinet, Department of Revenue.

2. Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation. KRS 131.130 and KRS 131.131.

3. Estimate the effect of this administrative regulation on the expenditures and revenues of a state or local government agency (including cities, counties, fire departments, or school districts) for the first full year the administrative regulation is to be in effect.

(a) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for the first year? No revenues are expected to be generated by updating this administrative regulation.

(b) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for subsequent years? None.

(c) How much will it cost to administer this program for the first year? No additional costs will be incurred in the first year of this regulation being in effect.

(d) How much will it cost to administer this program for subsequent years? No additional costs will be incurred in subsequent years.

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

Revenues (+/-):

Expenditures (+/-):

Other Explanation: